



BOB.SUSSMAN@LW.com

11/30/2006 03:30 PM

To John Hannon/DC/USEPA/US@EPA, Adam  
Kushner/DC/USEPA/US@EPA, Karl  
Simon/DC/USEPA/US@EPA, Anne  
ahebert@arb.ca.gov,  
cc Patrick.Charbonneau@Nav-International.com,  
David.Piech@Nav-International.com

bcc

Subject Stockpiling Legal Analysis

All:

At our November 21 meeting, we discussed the legal basis for EPA enforcement action to prevent stockpiling of 2006 engines for use in 2007 vehicles. Following this discussion, we've analyzed EPA anti-stockpiling policies from a regulatory and statutory perspective and wanted to share the results of our analysis.

In sum, EPA has consistently treated "stockpiling" of engines -- i.e. the production or banking of an excessive number of engines in one model year with the purpose or effect of circumventing more stringent emission standards in the following model year -- as a violation of the Clean Air Act (CAA). Several EPA regulations specifically prohibit stockpiling. Even where a standard does not outlaw stockpiling per se, EPA guidance demonstrates that it constitutes a "prohibited act" under CAA Section 203 and is therefore subject to injunctive relief under Section 204 and civil penalties under Section 205.

**1989 Guidance Letter.** The fullest statement of EPA's position on stockpiling is found in a November 22, 1989 letter from Mary Smith, Director of EPA's Office of Mobile Sources (now OTAQ), to the Public Transportation Division of the City of High Point, North Carolina, which states that:

"The sale of 1990 model year heavy-duty diesel engines for use in 1991 model year heavy-duty vehicles is not in itself a violation of the Clean Air Act or of any regulations under the Act. However, EPA regards stockpiling of engines to avoid compliance with later, more stringent emissions standards as circumvention of the requirements of the Act. Manufacturers involved in such stockpiling could be liable for civil penalties under the Act. Thus, an engine manufacturer who sells engines to a vehicle manufacturer cannot sell engines in a current model year for the purpose of having them installed in a future model year's vehicles when the engine sale is beyond that required to meet normal production lead time requirements, and is intended to avoid complying with the more stringent emission requirements of a future model year. Similarly, an engine manufacturer who installs its engine into its own vehicles cannot install current model year engines in future model year vehicles when such engine installation exceeds that needed to meet normal lead time requirements, and is intended to avoid complying with emission requirements which could otherwise apply to the model year in which the engine is installed."

Significantly, EPA bases this guidance not on specific regulations but on the "requirements of the Act." Moreover, the EPA guidance applies not just to engine manufacturers who improperly sell engines in a current model year for use in the next model year but to integrated vehicle/engine manufacturers who install such engines in trucks in greater quantities than required to meet normal lead time requirements.

The 1989 guidance letter has been cited in later Federal Register notices as a statement of EPA's "longstanding" position on stockpiling.

**EPA Regulations and Preambles.** EPA's final non-road rule for small non-road spark-ignition (SI) engines affords a limited opportunity for vehicle and equipment manufacturers to use engines produced before the compliance date of the new standards until inventories of these engines are depleted but states that "stockpiling of such non-road engines will be considered a violation" of the CAA. 40 CFR 90.1003(b)(4). The preamble to this rule explains that: "As long as vehicle and equipment manufacturers do not inventory engines outside of normal business practice (that is, as long as they do not stockpile non-certified engines), they will be considered to be in compliance" with the CAA. 60 FR 3458, 34595 (July 3, 1995).

EPA issued a direct final rule clarifying the application of stockpiling requirements to both small SI non-road and marine engines on August 7 1997. The rule identified a range of circumstances where non-certified engines could be used after the effective date of new standards but reaffirmed the general prohibition on stockpiling included in the original 1995 SI non-road rule. 62 FR 42638, 42640. EPA advised that:

"No corresponding provision is found in the Marine SI rule, however, this regulation is essentially a codification of longstanding EPA policies implementing Section 203(a) of the Act. These policies are similarly applicable to marine engines. See, for example, EPA's letter of November 22, 1989 to the Public Transportation Division of the City of High Point, North Carolina. Copy in docket."

EPA has formally extended the stockpiling prohibition to larger non-road engines subject to Tier I requirements: "As long as vehicle and equipment manufacturers do not inventory engines outside of normal business practices (that is, as long as they do not stockpile non-certified engines), they will be considered to be in compliance." 59 FR 31306 (June 17, 1994). Subsequently, this provision was extended to additional non-road emission requirements: "The Tier 1 rule . . . prohibited purposeful stockpiling of uncertified engines. EPA is extending this provision to Tier 1-to-Tier 2 and Tier 2-to-Tier 3 transitions as well as to the under 37kW engines." See 40 CFR 90.1003(b)(4) ("Stockpiling (i.e. build-up of an inventory of uncertified or Phase 1 engines beyond normal business practices to avoid or delay compliance with the Phase 1 or Phase 2 regulations in this part, respectively) will be considered a violation of this section.")



The preamble to the model rule contains the following discussion of this provision:

"Stockpiling has historically referred to situations where a vehicle manufacturer might seek to acquire engines in excess of normal business needs just prior to the effective date of a new, more stringent emission standard. As drafted in the Model Rule, the prohibition against stockpiling would make the sale of such vehicles unlawful after the effective date of the new emission limitation, as well as acquisition of vehicles by a fleet operator in excess of business needs, where it can be shown that the purchases were made in order to avoid purchasing cleaner engines or vehicles."

Individual states adopting the California standards have in some cases adopted stockpiling prohibitions. For example, the New Jersey rules state that "no person shall purchase any HDDEs or HDDVs in excess of normal business needs for the purpose of evading the requirements of this subchapter." The Delaware rules state that: "The purchase of engines or vehicles in excess of normal business needs for the purpose of evading the requirements of this section shall be unlawful. No heavy-duty vehicle that is manufactured after January 1, 2007, may be sold, leased or registered in Delaware unless it contains an engine certified by CARB as meeting all requirements of Title 13, CCR, section 1956.8 that apply to Model Year 2007 and subsequent engines."

These prohibitions indicate that there would be a high level of concern by states counting on the 2007 emission reductions if EPA failed to take vigorous action to prevent stockpiling of engines to circumvent the 2007 standards.

.....

In sum, the CAA as consistently interpreted by EPA over many years prohibits the stockpiling of engines that do not meet 2007 emission requirements. EPA should take prompt and forceful action to enforce this prohibition.

We look forward to your comments and questions about our legal analysis. Do not hesitate to call me to continue our discussions. International appreciates your attention to this matter.

**Robert M. Sussman**

**LATHAM & WATKINS LLP**  
555 Eleventh Street, NW  
Suite 1000  
Washington, DC 20004-1304  
Direct Dial: (202) 637-2183  
Fax: (202) 637-2201  
Email: [bob.sussman@lw.com](mailto:bob.sussman@lw.com)  
<http://www.lw.com>

**CAA Section 203(a).** Although there are no specific stockpiling provisions in EPA on-highway rules, EPA's 1989 guidance letter expressly applies to on-highway engines and vehicles and the Agency's position (as stated above) has been that Section 203(a) of the Act itself prohibits stockpiling and thus specific regulatory language is unnecessary. Section 203(a)(1) defines "prohibited act" as follows:

"in the case of a manufacturer of a manufacturer of new motor vehicles or new motor vehicle engines for distribution in commerce, the sale, or the offering for sale, or the introduction or delivery . . . of any new motor vehicle or new motor vehicle engine, manufactured after the effective date of regulations under this part which are applicable to such vehicle or engine unless such vehicle or engine is covered by a certificate of conformity issued (and in effect) under regulations prescribed under this part . . ."

As the EPA guidance demonstrates, the Agency has in effect determined that an engine is not covered by a valid certificate where it is manufactured in one model year (2006) with the purpose or result of delaying or circumventing compliance with new emission standards that take effect in the following model year (2007). In this situation, the engine is in reality a 2007 engine, notwithstanding its date of production, and therefore can only be sold or used if certified to 2007 emission limits. Without such a certificate in effect, sale or delivery of the engine or a vehicle containing it is a "prohibited act."

This approach is essential to assure the fairness and integrity of EPA emission standards. Otherwise, engine manufacturers and their customers would have *carte blanche* to artificially increase engine production before the effective date of the 2007 standard and then use this inventory to build trucks containing these non-compliant engines well into 2007 and even beyond. This would reduce if not eliminate the emission benefits of the new standard, which are anticipated to be very large given the sizable reductions in PM and NOx emissions that will occur from 2004 levels. In addition, because of the substantial cost differential between pre- and post-2007 engines, truck manufacturers who stockpile non-complying engines will enjoy a dramatic competitive advantage, penalizing those companies who have lawfully designed their 2007 launch strategies to minimize reliance on 2006 engines to the greatest extent consistent with the lead time requirements for a quality launch.

**CAA Section 202(b).** Section 202(b)(3)(A)(ii) authorizes EPA to issue regulations defining the term "model year" "[f]or the purpose of assuring that vehicles and engines manufactured before the beginning of a model year were not manufactured for purposes of circumventing the effective date of a standard" promulgated under Section 202. In 1995, EPA issued model year regulations but they were narrowly tailored to resolve conflicting court decisions under CAA 177 and didn't address stockpiling. See 40 CFR 85.2301-2305; 60 FR 4733 (January 24, 1995). Nonetheless, the language of Section 202(b)(3)(A)(ii) unmistakably demonstrates Congress' concern about stockpiling and reinforces the need to interpret Section 203(a) in a manner that defines stockpiling as a violation of the Act.



Separately, if an engine manufacturer provides false or misleading information during the certification process, EPA may later void the engine certification because the underlying certification was issued on false pretenses. Engine manufacturers are expected to provide accurate and true information during the certification application process. Included in this information is a reasonable estimate of annual engine production. 40CFR86.094-21b2. This information is especially necessary for engines participating in Average, Banking and Trading programs and enables EPA to completely evaluate the engine's compliance with the CAA, its regulations and underlying guidance. See 40CFR86.004-15b1ii and b1iii. If the actual engine production is found to be significantly greater than that estimate originally provided by the manufacturer because of engine stockpiling, this deviation would provide a basis for withdrawing the manufacturer's certificate, in which event 2006 engines stockpiled for use in 2007 would be in violation of Section 203(a)(1) and could not be lawfully assembled into 2007 model year trucks.

**Diesel Consent Decrees.** EPA's diesel consent decrees provide further evidence of the Agency's long-standing concern about production and manufacturing strategies that circumvent emission standards. All of the decrees contain the following language:

"[Name of company] shall not, directly or indirectly through its dealers, distributors or other third-parties . . . circumvent the requirements of this Consent Decree through leasing, licensing, sales or other arrangements, or *through stockpiling (i.e. build-up of an inventory of engines outside normal business practices before a new limit under this Consent Decree takes effect )* (emphasis added).

This prohibition applied to the introduction of new engines under EPA's 2004 emission standards. It would be anomalous if stockpiling to circumvent these standards were prohibited while efforts to circumvent the 2007 standards (which require larger emission reductions) were permitted.

**State Actions.** Finally, while the 2007 regulations themselves do not contain an express anti-stockpiling provision, stockpiling has been of concern to states considering adoption of the California 2007 standards. STAPPA-ALAPCO developed a "model rule" for states opting into the California standards which contained the following provision:

"The purchase of engines or vehicles in excess of normal business needs for the purpose of evading the requirements of this Part shall be unlawful. No heavy-duty vehicle that is manufactured after April 1, 2007, may be sold, leased or registered in this State unless (1) it contains an engine certified by CARB as meeting all requirements of Title 13, CCR, section 1956.8 that apply to Model Year 2007 and subsequent engines and (2) the sale, lease or registration of such vehicle will not result in a violation of the phase-in, averaging, banking or trading or early incentive provisions of this Part."

This email may contain material that is confidential, privileged and/or attorney work product for the sole use of the intended recipient. Any review, reliance or distribution by others or forwarding without express permission is strictly prohibited. If you are not the intended recipient, please contact the sender and delete all copies.

Latham & Watkins LLP

\*\*\*\*\*  
\*

To comply with IRS regulations, we advise you that any discussion of Federal tax issues in this e-mail was not intended or written to be used, and cannot be used by you, (i) to avoid any penalties imposed under the Internal Revenue Code or (ii) to promote, market or recommend to another party any transaction or matter addressed herein.

For more information please go to

[http://www.lw.com/resource/Publications/\\_pdf/pub1289\\_1.pdf](http://www.lw.com/resource/Publications/_pdf/pub1289_1.pdf)

\*\*\*\*\*  
\*

This email may contain material that is confidential, privileged and/or attorney work product for the sole use of the intended recipient. Any review, reliance or distribution by others or forwarding without express permission is strictly prohibited. If you are not the intended recipient, please contact the sender and delete all copies.

Latham & Watkins LLP